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No. 371

In the Supreme Court of the United States

OCTOBER TERM, 1940

ESTATE OF ANNA M. KELLER, PIUS P. KELLER AND MARCELLA V. KELLER, EXECUTORS, PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 19–28) is reported in 39 B. T. A. 1047. The opinion of the Circuit Court of Appeals (R. 71–77) is reported in 113 F. (2d) 833.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 28, 1940 (R. 77). The petition for a writ of certiorari was filed August 23, 1940, and was granted October 14, 1940 (R. 78). The jurisdiction of this Court rests on Section 240 (a)

of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The decedent at 74¾ years of age was uninsurable. However, in conjunction with her purchase of an annuity, there was issued to her a so-called single premium life insurance policy. The effect of the combined annuity and insurance policies was to eliminate the risk inherent in life insurance on the part of the insurance company and to provide decedent's beneficiary with no protection against loss resulting from death.

The question presented is whether, in these circumstances, the proceeds of the so-called insurance policy constituted an amount receivable "as insurance" within the meaning of Section 302 (g) of the Revenue Act of 1926, thereby enabling the decedent's estate to claim the special $40,000 estate tax exemption applicable to insurance.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory provisions and regulations will be found in the Appendix to the Government's brief in *Helvering* v. *Le Gierse, et al.*, No. 237, present Term, with which the present case is to be argued.

STATEMENT

The facts, as found by the Board of Tax Appeals (R. 10–18), may be summarized as follows:

Petitioners are the executors of the estate of Anna M. Keller, who died on March 28, 1936 (R.

10–11). The cause of decedent's death was a cerebral hemorrhage of one-half day's duration. Until the time of her death, decedent had enjoyed excellent health (R. 18).

On December 31, 1934, the decedent, who was then almost 75 years of age, entered into an agreement with the Equitable Life Assurance Society of the United States, pursuant to which the company issued to her two "policies." One was an annuity contract in standard form and the other was a so-called "Single Premium Life Policy", also in standard form, containing the usual provisions for cash surrender, change of beneficiary, optional modes of settlement at maturity, etc. (R. 11–13). The insurance policy also contained a provision for participation in dividends (R. 12). The insurance company would not have issued the insurance policy without the annuity contract because of the age of the decedent. It would have issued the annuity contract without the insurance policy. No physical examination of decedent was required by the insurance company (R. 14).

The annuity contract provided for payment to the decedent of $390.84 per year; the life-insurance contract provided for the payment of $20,000 to the decedent's daughter upon the decedent's death (R. 11). For the two policies the decedent paid the insurance company in advance the sum of $21,200; of that amount $3,258.20 represented the premium for the annuity contract, and $17,941.80

represented the premium for the "insurance" policy (R. 11–12). The annuity payments which the insurance company agreed to make to the decedent amounted to slightly less than 2 percent of the aggregate amount paid by decedent to the company, and this was considerably less than the insurance company was earning on its own funds held for investment (R. 17). The total amount to be paid by the company at decedent's death was $1,200 less than the aggregate amount paid by the decedent to the company, the total premiums being 106 percent of the face amount of the "insurance" policy (R. 14).

The name given to the $1,200 excess in the aggregate amount of the premiums over the face amount of the policy is "loading" and is for the purpose of paying commissions to the general agent and the special agent and for premium taxes. The actual expense, exclusive of general overhead expense, of the insurance company in issuing the two policies was $1,475.97. The total charge of 106 percent for combined annuity and life insurance contracts was later found by the insurance company to be unprofitable and the charge was increased to 110 percent. Still later the issuance of an insurance policy like the one here involved was made conditional upon a medical examination (R. 14–15).

Each policy provided that the policy and the application therefor "constitute the entire contract between the parties" (R. 11–12). The premiums on the policies were computed on the basis of dif-

ferent mortality tables, the mortality table used for the annuity policy showing a longer life expectancy for the decedent than that used for the insurance policy (R. 14).

The company treated the two contracts as two separate transactions. Although the amounts received from decedent for both policies were merged with the general funds of the company, the premiums were credited to different accounts and the commissions paid were likewise charged to different accounts. Similarly, in its reports to the state Superintendent of Insurance, the company reported its liability with respect to the two policies under different headings (R. 15–16).

The Commissioner determined that both policies were purchased as part of a single transaction, that the proceeds of the life insurance policy were not received "as insurance" within the meaning of Section 302 (g) of the Revenue Act of 1926, and that, consequently, decedent's estate was not entitled to the $40,000 insurance exemption provided by Section 302 (g). Treating the entire transaction as a transfer made to take effect at or after death within the meaning of Section 302 (c) of the 1926 Act, the Commissioner determined a deficiency of $3,243.64 (R. 5–7). The Board of Tax Appeals reversed this determination, holding that the proceeds of the life insurance policy were received "as insurance" and that the estate was therefore entitled to the exemption (R. 19–26). The Circuit Court of Appeals, re-

garding the issuance of the two policies as a single transaction eliminating all insurance risk (R. 74), reversed the decision of the Board of Tax Appeals (R. 77).

ARGUMENT

This case presents the same question as that involved in *Helvering* v. *Le Gierse et al.*, No: 237, present Term with which the present case is to be argued. Reference is made to the Government's brief in the *Le Gierse* case for the principal arguments in support of our position here. Several of the contentions advanced by petitioners in this case, however, require further brief comment.

1. Petitioners attempt to establish the independence of the two contracts by pointing to the fact that the rate of the premium charged for each policy was computed without reference to the rate of the premium to be charged for the other (Br. pp. 12, 14). This fact is only a half truth. Although the rate of each premium may have been determined without reference to the rate of the other, the rate of each was determined by reference to the same factor—the life expectancy of the insured. As we point out in our brief in the *Le Gierse* case (pp. 18–20), it is precisely because the life expectancy of the insured is the basic element in the computation of both premiums that the two types of policies, when issued in conjunction, serve to counteract one another economically.

The situation is not altered by the fact that the insurance company used different mortality tables in computing decedent's life expectancy for purposes of the two policies. The record reveals that the mortality table used for the annuity contract shows a longer life expectancy for a woman of decedent's age than the mortality table used for the insurance contract (R. 14). Certainly the fact that the insurance company in each instance used the mortality table most favorable to it in no way detracts from our position that, by issuing the two policies in conjunction, the company eliminated all insurance risk.

Although, for the reasons stated, it is not necessary for the elimination of insurance risk that the rate of each premium be computed with reference to the rate of the other, it is necessary that the amount of the annuity issued to the insured be computed with reference to the amount of the insurance policy which is taken out; i. e., the annuity must be large enough so that the premium paid for it will, when added to the premium paid for the insurance policy, equal or exceed the face amount of the insurance policy. And the record in this case shows that this is exactly what the insurance company required. At the time of its agr ment with the decedent, the company was issuing what is called "the 106 per cent combination" (R. 54); that is, the company required the

issuance of an annuity policy large enough so that the aggregate premiums paid by the insured for that policy and for the insurance policy amounted to 106 percent of the face amount of the insurance policy. Later, when this proved to be unprofitable because of the amount of the "loading" expenses, "the charge was increased to 110 percent" (R. 15); in other words, the insured, for the same amount of "insurance" was required to buy a larger annuity. A more conclusive demonstration of the complete interdependence of the two policies would be difficult to imagine.

Attention is also invited to the following finding of the Board (R. 14), which is based on the testimony of an insurance agent called as a witness by petitioners (R. 53–57):

> The total consideration paid by the decedent to the insurance company for the two contracts amounted to 106 percent of the face amount of the insurance policy or $21,200, which was $1,200 in excess of the face amount of the insurance policy. The name given to the $1,200 by the insurance company is "loading" and is for the purpose of paying commissions to the general agent and the special agent and for premium taxes.

This finding shows clearly the purpose and intent of the insurance company, by the issuance of the two policies in conjunction, to assure payment to

itself of an aggregate amount equal to the face amount of the insurance policy, together with an amount to cover "loading" expenses. It furnishes complete refutation of the contention that the two policies were regarded by the company as independent of one another.

2. Petitioners' contention that the company assumed an insurance risk is completely without merit. It is true that the Board found that through the issuance of the annuity contract in connection with the insurance policy, "the company reduced but did not entirely eliminate its risk against loss due to premature death" (R. 14). But the findings, when read as a whole, and the testimony of petitioners' witness upon which the findings were based (R. 52–58), show that what the Board had reference to was the fact that, if the decedent died within a short time after entering into the agreement, the company would suffer an out-of-pocket loss of some $275.97 because the "loading" charges included in the premium payments were less by that amount than the actual loading expenses. Certainly, as the court below stated (R. 74), the fact that the company may have made a slight miscalculation in loading charges does not establish that, in entering into the agreement, it undertook an insurance risk. It is significant that, sometime after the contract with decedent was made, the company required 110 percent

rather than 106 percent coverage of the face amount of the insurance policy, thus providing for all loading charges in full.

In this connection, it is interesting to contrast the findings of the Board in this case, in the *Le Gierse* case, and in *Tyler* v. *Helvering,* No. 368, present Term, all of which involve the same question. Here, where 106 percent coverage was required, the Board found a reduction but not an entire elimination of risk of loss; in the *Le Gierse* case, where 108½ percent coverage was required, the Board found that "it could be stated with almost certainty" that there would be no loss (R. 14); and in the *Tyler* case, where 110 percent coverage was required, the Board found that the agreement "could not involve the insurance company in any loss" (R. 15). Since the same type of transaction was entered into in each of the cases, it is apparent that the difference in the Board's findings is based solely on the difference in the calculation of "loading" charges; as we have stated, this does not involve an insurance risk.

Petitioners' further argument (Br. 22) that, if decedent had died shortly after making the agreement, there would have been no contribution to the company's general overhead and no profit to the company is plainly irrelevant. Any contribution to general overhead would, of course, reduce the overhead attributable to the company's other business and would therefore make that other

business more profitable. But the absence of profit clearly does not establish the presence of loss and, as we point out in our brief in the *Le Gierse* case (pp. 12–15), it is risk of loss which is the essential element of insurance.

Finally, petitioners seek to establish a risk of loss by pointing to the situation which would have existed had the decedent during her lifetime surrendered the life insurance policy for its cash surrender value but left the annuity contract in force; they assert that the court below erred because it failed to take this possibility into account (Br. 27–28). But the inquiry of the court below was directed, as the inquiry must be directed here, to the question of whether there was an insurance risk, and this necessarily assumes continuance of the insurance policy. If the policy were cancelled, there would obviously remain no insurance risk. Consequently, a showing of risk of loss on the annuity policy based upon cancellation of the insurance policy cannot be used to establish the existence of insurance. As a matter of fact, the risk of loss on the annuity policy in this situation would be less than the ordinary risk of loss on an annuity policy issued alone, since the company would have received, as consideration for its assumption of risk, not only the ordinary premium but also the difference between the premium for the insurance policy and the cash surrender value of that policy. Stated otherwise, cancellation of

the insurance policy, far from creating an insurance risk, would have assured the company a profit on the issuance of the policy.

CONCLUSION

The decision of the court below should be affirmed.

Respectfully submitted.

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SUPREME COURT OF THE UNITED STATES.

No. 371.—October Term, 1940.

Pius P. Keller, and Marcella V. Keller, Petitioners, *vs.* Commissioner of Internal Revenue, Respondent.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[March 3, 1941.]

Mr. Justice Murphy delivered the opinion of the Court.

This case is companion to Number 237, *Helvering* v. *Le Gierse*, decided this day. In all material respects the facts are alike except for the differences to be noted. Here the annuity contract provided for annual payments of $390.84 and cost decedent $3,258.20. The "insurance" policy stipulated for payment of $20,000 to decedent's daughter at decedent's death, and the single premium was $17,941.80. Decedent was 74 at the time the contract was executed and died about two years later. Proceeding on the same theory as in the *Le Gierse case*, the Commissioner assessed a deficiency in the federal estate tax which the Board of Tax Appeals reversed. 39 B. T. A. 1047. The Circuit Court of Appeals in turn reversed the Board of Tax Appeals. 113 F. (2d) 833. The case is here because of conflict with the *Le Gierse* case (110 F. (2d) 734). 311 U. S. —.

Petitioners contend that this case is distinguishable from the *Le Gierse* case because here the insurance company found that the total consideration for the two contracts, which was 106% of the face value of the policy, was inadequate. They point out that the rate for this combination of contracts was later increased to 108% and finally to 110%. Further, they contend that absence of physical examination does not establish absence of risk, and that the Board of Tax Appeals found that there was "some" risk to the insurance company.

We find the distinctions insufficient to require a different result. It is not enough to show that the insurance company assumed "some" risk. A bank assumes a risk when it accepts a depositor's

funds and invests them. The investment may prove to be an unsafe one, or the bank may have agreed to pay the depositor a higher rate of interest than it can profitably earn on the funds it invests. Indisputably this is a risk. But it is not an insurance risk in the sense explained in the *Le Gierse* case. That the insurance company subsequently changed the total charge for this particular combination of contracts because it was unprofitable does not establish the existence of an insurance risk. Rather, it illustrates strikingly the interrelation of the two agreements and emphasizes the effort of the company to remove all possible investment risk.

Absence of a physical examination may well be inconclusive as to the existence of an insurance risk. For example, some companies do not require such an examination for group insurance. But there the risk as to one is distributed among the group, an insurance risk squarely within the definition stated in the *Le Gierse* case. Here the annuity issued with the policy did more than substitute for a physical examination. It removed the necessity for any risk distribution and completely countervailed a risk otherwise assumed in the "insurance" policy.

The finding by the Board of Tax Appeals that there was some risk necessarily is ambiguous in view of their finding that the company annually earned from 3½ to 4 percent on its own investments. It is therefore reasonable to conclude that the "risk" referred to was a risk that the funds might not earn enough to cover profitably the annuity payable to the decedent, or a risk due to a miscalculation of the proper total consideration. In either event it is not a finding of the existence of an insurance risk.

Since the case is not distinguishable from *Helvering* v. *Le Gierse*, *supra*, the judgment of the Circuit Court of Appeals is affirmed.

The CHIEF JUSTICE and Mr. Justice ROBERTS think the judgment should be reversed for the reasons stated in the opinion of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Le Gierse*, 110 F. (2d) 734.